United States Courts
Southern District of Texas
FILED

JUL 12 2002

Michael N. Milby, Clerk

IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

IN RE ENRON CORPORATION SECURITIES LITIGATION	§ § § §	CIVIL ACTION NO. H-01-3624 Consolidated
THIS DOCUMENT RELATES TO: All Cases Consolidated with Newby And The Regents of the University Of California	§ § § §	CLASS ACTION

PREFERRED PURCHASER PLAINTIFFS' MEMORANDUM RESPONDING TO THE REGENTS' AND MILBERG WEISS' JULY 5, 2002 RESPONSE

The preferred purchaser plaintiffs submit this memorandum and attachments in response to the California Regents' brief of July 5 (the "July 5th brief").

The Regents missed the material point: Their conduct caused the current dispute and has put in jeopardy legally cognizable claims of preferred purchasers who purchased their Enron preferred shares pursuant to public offerings on November 18, 1996 and January 13, 1997. In seeking to be appointed sole lead plaintiff and sole lead counsel, the Regents and their counsel argued against the appointment of other classes and subclasses asserting that they could and would represent the interests of all classes of Enron security purchasers including the preferreds. In so doing, they clearly assumed a fiduciary duty to all preferred purchasers. They breached that duty by not asserting all potential claims on behalf of preferred purchasers who purchased their shares during the period November 18, 1996 through October 18, 1998. They abandoned those class members entirely leaving them with no legal remedy unless those claims are now asserted on their behalf in this action.

The Regents and their counsel created this conundrum by refusing to consult with counsel for the preferred purchasers prior to filing the April Consolidated Complaint. We attempted to head off this problem by requesting a draft of the complaint prior to its filing (see

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Wolf Haldenstein letters dated Feb. 19, Mar. 7 and Mar. 12, 2002, attached hereto as Exhibit 1). They rejected our request (see Milberg letters dated Mar. 11 and Mar. 12, 2002, Exhibit 2 hereto). Now at this late date over their strenuous objections we ask this court to permit our clients to file the proposed Supplement to the April Consolidated Complaint to give these preferred purchasers their day in court.

The Regents implicitly concede in the July 5th brief that there are legally cognizable claims that can be asserted on behalf of the preferred purchasers and that are not contained in the current Consolidated Complaint. In a transparent attempt to cover up their omission they argue, as if they were defense counsel without a fiduciary duty to these plaintiffs, that these claims are relatively weak and subject to certain defenses. However, they can point to no controlling authority which would require dismissal of these claims nor do they contend that these claims are frivolous. Instead, once all their verbiage is omitted, they concede that these claims may be viable but would be more difficult and time consuming to prove. A true fiduciary would not be deterred by those obstacles particularly when these claims are the only claims available to these preferred purchaser.

The Regents attached 5 exhibits to their brief, none of which is the proposed Supplement we submitted to them. To complete the record before this court we have attached a copy of this Supplement as Exhibit 3 to this memorandum recognizing that it may arguably be attorney's work product.[1]

We submit this Supplement should be filed and these claims should be litigated. Contrary to the assertion to the California Regents, only this court can determine whether these

[1] We include the Supplement only in the copies filed with this Court and served upon Milberg Weiss.

claims would survive. The Regents are correct in asserting that these claims should not be prosecuted by them or their counsel but instead should be prosecuted by the plaintiffs named therein and their chosen counsel, the Wolf Haldenstein firm. Indeed, all preferred purchaser claims should be separately prosecuted by those plaintiffs and their counsel whose sole concern is maximizing the recovery for this class of Enron security purchasers.

The Regents and Milberg Weiss' Factual and Legal Analysis

The issue goes beyond our point by point disagreement with the Regents' factual and legal analysis. The issue is why is the Regents sandbagging its own class members' claims. We submit that a detailed response to the Regents' misleading factual and legal analysis is inappropriate and should instead be reserved for defendants' inevitable motion to dismiss.

We note in passing that we sent Milberg an early draft of the proposed Supplement upon only four days notice. The Regents had asked us to send us a draft on two days notice, which we stated was unreasonable. (We finally agreed to four days.) Contrary to Milberg's grossly misleading suggestion to this Court at pages 3 and 4 of its July 5th brief that our early draft contained only damage claims, our June 20th draft sent to Milberg contained both rescission and damage claims. Milberg stated that it thought all the claims were barred by SLUSA.[2] After further consideration, we withdrew the damage claims but continued to maintain

[2] We disagree with Milberg's characterization (July 5th brief at 3) that it has been engaged in a thorough ongoing discussion with us concerning these claims. We think they have been uncommunicative and uncooperative. The Supplement dated July 9, 2002 and included herewith as Exhibit 3, is materially unchanged from the June 26th draft, contains the identical claims to the June 26th draft, adds just four paragraphs, and Milberg on July 2, 2002 received a copy of the draft with those changes. This July 9 Supplement also cleans up a few typographical errors.

the rescission claims.[3] The Regents concede that the rescission claims may be viable, but suggest prosecuting them may be "risky" and "time consuming" (see infra).

Second, the Regents assert in their brief that the unlawful conduct by the defendants only began in January 1997, because Enron's restatement of its financial statements only goes back to that date. But, even under the PSLRA, a restatement of earnings is not a requisite for unlawful conduct under the securities laws. Aldridge v. A.T. Cross Corp., 284 F.3d 72 (1st Cir. 2002). Indeed, the preferred purchaser plaintiffs allege numerous facts pre-January 1, 1997 demonstrating both unlawful conduct and scienter, both new facts and some facts which are alleged in the Consolidated Complaint (see Supplement, Ex. 3, passim).[4]

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[3] As to the rescission claim, it is not barred by SLUSA, which is applicable only to a "covered class action" which seeks "damages." SLUSA states: "The term 'covered class action' means – (i) any single lawsuit in which – (I) damages are sought on behalf of more than 50 persons . . . . ; or (II) one or more named parties seek to recover damages on a representative basis on behalf of themselves and other unnamed parties similarly situated . . . . ; or (ii) any group of lawsuits filed in or pending in the same court and involving common questions of law or fact, in which – (I) damages are sought on behalf of more than 50 persons . . . ." Definitions, Subsection (f)(2)(A). Although unnecessary, since the statute speaks for itself, and the statutory language is controlling, the limited case law supports this conclusion. Wald v. C.M. Life Ins. Co., No. 3:00-CV-2520-H, 2001 U.S. Dist. LEXIS 2593 (N.D. Tex. Mar. 8, 2001) (in action where damages were not sought, claims seeking only declaratory and injunctive relief are not barred by SLUSA). The preferred purchasers' complaint Supplement seeks rescission under the TSA for both public offerings, Enron Capital Trust I and Enron Capital Trust II. The TSA states that a plaintiff may "sue either at law or in equity for rescission, or for damages if the buyer no longer owns the security." TSA § A.2.

As to the damages claim under the TSA, we note that there are no court decisions addressing whether a state-law damages claim is barred by SLUSA where the three year federal statute of limitations already has expired, and hence the claim could never be brought as a federal securities law claim. Nevertheless, we deleted the damage claims in deference to Milberg's objection.

[4] We note that the various motions to dismiss the TSA claim (Claim Four) in the Consolidated Complaint argued that this claim did not sufficiently separate claims under the various subsections of the statute. Having read the initial briefs in support of the dismissal motions, and the Regents' responses, we have remedied that issue in the Supplement.

Indeed, the Regents cannot have it both ways. On the one hand, the Regents quite clearly allege an unlawful course of conduct by the defendants which included numerous public offerings, including public offerings before the commencement of the Federal Class Period on October 18, 2001. The Regents also allege a Texas Securities Act claim -- which alleges that it seeks both rescission and damages -- with respect to an IPO which occurred before the three-year federal claim statute of limitations. Yet, on the other hand, although the preferred purchaser plaintiffs allege a continuation of the same unlawful conduct, to include additional IPOs in the pre-October 18, 1998 time period, the Regents seek to deny the preferred purchaser plaintiffs the right to pursue this claim, which is their only claim.

The defendants may argue that the relation-back doctrine does not apply to these claims even though the Consolidated Complaint alleges an ongoing course of conduct, which included initial public offerings prior to the commencement of the federal class period; where 26 of the 33 defendants named in the Supplement are already defendants herein; where these very same Enron preferred share public offerings are named in the Consolidated Complaint under the heading "Enron's Access to the Capital Markets" (CC¶48); and where the Consolidated Complaint in that very same paragraph alleges that Enron had easy access to the capital markets because of its ongoing, illicit transactions. Id. The California Regents should not be making their arguments for them. To be sure, the Regents have hedged their bets -- they do not state that the claims sought to be pursued by the preferred purchasers are not valid, they simply state that these claims are (among other things) riskier and too time consuming for them to pursue; a strange position for a genuine fiduciary to take.[5]

[5] Concerning notice under Federal Rule of Civil Procedure 15(c), the claims asserted in the Supplement clearly arose out of the same ongoing course of conduct asserted in virtually every (continued...)

Litigation Is Not Necessarily a "Walk in the Park" for a Class Counsel

The cause of the dispute here over the Supplement containing the preferred purchaser claims is quite simple: Milberg Weiss refused to discuss their draft Consolidated Complaint with the Preferred Stock Purchasers counsel prior to its filing. If these claims had been contained in the Consolidated Complaint then, yes, defendants could argue (we submit unsuccessfully) that the relation-back doctrine does not apply. But, it is the Regents and Milberg who seek to deprive some of their own class members of their day in court, using weasel-worded qualified adjectives that a claim might not exist, when it should be up to the defendants to unqualifiedly win a dispositive motion ending the preferred plaintiffs' day in court. For example, the Regents and Milberg, throughout their brief, use phrases such as:

> the preferred purchaser claims "would divert attention away from and place at risk the substantially stronger claims currently asserted" (at 1);
>
> the preferred purchaser claims "should not be allowed to impede the efficient litigation of this massive and highly complex matter" (at 2);
>
> "the strength of [the preferred purchaser] claims appears to be far less certain than the detailed allegations of fraud asserted on behalf of the Class in the Consolidated Complaint" (at 8n.5);
>
> "it is doubtful that many of the original purchasers of the Preferred Stock still hold their shares" (at 11); and
>
> "The defendants may persuasively argue that the 1996-97 Preferred Purchaser Claims are likely time barred" (at 11).

(...continued)
complaint which has been consolidated before this Court, including but not limited to the Consolidated Complaint. As least as early as December 21, 2001, the Preferred Purchaser Plaintiffs filed with this Court and served papers which referred to the Enron Capital Trusts I and II preferred stock purchasers' potential IPO-like claims with respect to these offerings, and that further factual investigation was ongoing. Newby Docket numbers, e.g., 73 (Initial Mem. in support at page 4). See discussion in Plaintiffs' Additional Memorandum.

We submit, contrary to the Regents, that pursuing these claims does not "divert attention from" and "place at risk" any other claims, nor would it "impede the efficient litigation" of this matter. Indeed, Milberg argued on its own behalf in its bid for lead counsel that it could staff the whole case efficiently. But, the whole case now seems to be equated to only that portion of the whole which would most benefit their client, the California Regents, not that portion which would benefit the preferred purchasers who they previously claimed they could and would represent with equal fidelity.

Conclusion

Accordingly, as contained in a proposed order submitted herewith, this Court should amend the Consolidated Complaint to add the Supplement, and should appoint Wolf Haldenstein Adler Freeman & Herz LLP as lead counsel (with McGehee & Pianelli, L.L.P. as local counsel) to prosecute those claims.

Dated: July 12, 2002

WOLF HALDENSTEIN ADLER FREEMAN & HERZ LLP

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February 19, 2002

via fax to both locations

Helen J. Hodges, Esq.
G. Paul Howes, Esq.
James I. Jaconette, Esq.

Guests at
The Houstonian
Houston, TX

and also to them at
Milberg Weiss
401 B Street
San Diego, CA 92101

Re: Enron, depositions of Andersen personnel this week in Houston, and other important issues concerning the Enron litigation

Dear Ms. Hodges and Messrs. Howes and Jaconette:

As you know, we made a lead plaintiff/lead counsel motion on behalf of the purchasers of Enron preferred stock. We write to you on behalf of the Enron preferred stock purchasers.

I. In light of Judge Harmon's statement in her February 15, 2002 Memorandum and Order appointing lead plaintiff and lead counsel that the "objections [of the Enron preferred stock purchasers] can be effectively handled by dividing the class when class certification becomes an issue" (Mem. At 29), we request that you provide us as soon as it is available with the transcript of each Andersen deposition being taken this week. If you are receiving a computer file/floppy disc of the transcript, please e-mail it to me as soon as it is available at "weintraub@whafh.com". More importantly, if any work is going to be done on a global

Exhibit 1

amended, consolidated complaint, we request that you include us on the drafting team to ensure that the material facts unique to the preferred stock purchasers are alleged in the amended complaint. We believe this is necessary, at a minimum, so that we will be in a position to participate on behalf of the preferred stock purchasers at the class certification stage.

II. Before your appointment as lead counsel, the understanding among the plaintiffs' law firms (during conference calls in which at least Ms. Hodges of your firm participated) was that a law firm not taking a deposition could submit questions to be asked at the Andersen depositions by the law firm taking that particular deposition this week. We request that you ask the following questions of each Andersen witness still to be deposed:

1. "With respect to the types of documents which existed, were any documents destroyed which concern whether Enron ever placed any limitation (or the like, however denominated) on the scope of the audit to be conducted by Andersen?"

2. "With respect to the types of documents which existed, were any documents destroyed which concern whether anyone at Enron tried to dissuade Andersen from looking carefully (or the like, however denominated) at any transaction?"

3. "With respect to the types of documents which existed, were any documents destroyed which concern whether Andersen provided tax advice to Enron in connection with its offshore corporations or partnerships?"

4. "With respect to the types of documents which existed, were any documents destroyed which concern whether Andersen provided advice to Enron in connection with the treatment of the offshore corporation or partnership transactions in Enron's tax returns?"

5. "With respect to the types of documents which existed, were any documents destroyed which concern whether Enron followed Andersen's advice in connection with the treatment of the offshore corporation or partnership transactions in Enron's tax returns?"

6. "With respect to the types of documents which existed, were any documents destroyed which concern whether Andersen signed Enron's tax return as a preparer?"

7. "With respect to the types of documents which existed, were any documents destroyed which concern whether Andersen was asked to sign Enron's tax returns as a preparer?"

8. "With respect to the types of documents which existed, were any documents destroyed which concern whether Andersen looked at, examined or the like, however denominated, the adequacy of Enron's income tax reserves to deal with the possible disallowance by the IRS of Enron's treatment of offshore entities or transactions with them?

A prompt response to this letter will be much appreciated. We look forward to working with you on this case in the interests of the Enron preferred stock purchasers. Thank you.

Sincerely,

Robert B. Weintraub

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March 7, 2002

via fax

William S. Lerach, Esq.
Milberg Weiss Bershad Hynes & Lerach LLP
401 B Street, Suite 1700
San Diego, CA 92101

Re: In re Enron Corp. Securities Litigation, Newby, Civ. No. H-01-3624

Dear Mr. Lerach:

As you know, we made a lead plaintiff/lead counsel motion on behalf of the purchasers of Enron preferred stock. We write to you (and to your law firm for a second time) on behalf of the Enron preferred stock purchasers.

Our February 19, 2002 letter to Milberg, Weiss requested that it: include us in the drafting of the consolidated complaint to ensure that facts and claims which are relevant and material to the Enron preferred stock purchasers are included in the complaint; send us transcripts of the Andersen depositions as soon as they were transcribed; and ask the Andersen deponents eight specific questions which we submitted to you. Milberg has not responded to our letter (nor did it send us the deposition transcripts). A copy of the letter is enclosed.

As you know, in her February 15, 2002 Memorandum and Order appointing lead plaintiff and lead counsel, Judge Harmon stated that the "objections [of the Enron preferred stock purchasers] can be effectively handled by dividing the class when class certification becomes an issue. Moreover, consolidation for pretrial matters does not necessarily mean that the claims will all be tried together, especially where the nature of the evidence and damage issues differ substantially." Mem. & Order at 29. Accordingly, we think that our participation in the drafting of the consolidated complaint will ensure that the Enron preferred stock purchasers' claims are properly asserted at this time. We also think that, at a minimum, our participation in drafting the discovery requests is necessary to ensure that documents pointedly relevant and material to the preferred purchasers' claims are demanded during production.

Given the Court's desire to move this case forward (as demonstrated by its April 1st deadline for filing consolidated complaints) and given your failure to respond to our February 19, 2002 letter, we request that you respond to us by the end of the business day in New York on March 12, 2002. Otherwise, our clients have asked that we seek from the Court clarification of its opinion and our role on behalf of the preferred stock purchasers.

We look forward to your early response.

Sincerely,

Robert B. Weintraub

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March 12, 2002

via fax

Helen J. Hodges, Esq.
Milberg Weiss Bershad Hynes & Lerach LLP
401 B Street, Suite 1700
San Diego, CA 92101

Re: In re Enron Corp. Securities Litigation, Newby, Civ. No. H-01-3624

Dear Ms. Hodges:

We have received your letter of March 11, 2002. Thank you very much for responding. The question remains, are you going to show us a draft of the consolidated complaint sufficiently prior to filing so that we can have realistic input in the drafting process on behalf of the purchasers of Enron preferred stock?

We look forward to your early response, in any event no later than close of business New York time this Friday, March 15, 2002.

Sincerely,

Robert B. Weintraub

Robert B. Weintraub

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March 11, 2002

VIA FACSIMILE AND U.S. MAIL

Robert B. Weintraub
WOLF HALDENSTEIN ADLER
FREEMAN & HERZ, LLP
270 Madison Avenue
New York, NY 10016

Re: Enron Securities Litigation

Dear Mr. Weintraub:

Thank you for your letters dated March 7, 2002 and February 19, 2002. As you are aware, Judge Harmon appointed the Regents of the University of California as Lead Plaintiff to represent *all* securities purchasers, including purchasers of preferred stock. I assure you that facts and issues relevant to purchasers of all Enron securities will be addressed in the consolidated complaint. Thus, your assistance is not needed at this time. Please avoid unnecessary work and expense as it will not be compensated or reimbursed.

Very truly yours,

Helen J. Hodges

HELEN J. HODGES

HJH:dsg

cc: William S. Lerach

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Exhibit 2

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March 12, 2002

VIA FACSIMILE

Robert B. Weintraub
WOLF HALDENSTEIN ADLER
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270 Madison Avenue
New York, NY 10016

Re: Enron Securities Litigation

Dear Mr. Weintraub:

In response to your March 12 letter, we will not be showing you a draft of the consolidated complaint prior to its filing.

Very truly yours,

Helen Hodges

HELEN J. HODGES

HJH:dsg

cc: William S. Lerach

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

IN RE ENRON CORPORATION SECURITIES LITIGATION	§	CIVIL ACTION NO. H-01-3624 Consolidated
THIS DOCUMENT RELATES TO: All Cases Consolidated with Newby And The Regents of the University Of California	§	CLASS ACTION

SUPPLEMENT TO THE CONSOLIDATED COMPLAINT FOR VIOLATION OF THE SECURITIES LAWS, ASSERTING ADDITIONAL FACTS AND CLAIMS ON BEHALF OF ENRON PREFERRED STOCK PURCHASERS

1. This Supplement to the Consolidated Complaint for Violation of the Securities Laws (which was filed on April 8, 2002) alleges class claims on behalf of purchasers of Enron Corporation's ("Enron" or the "Company") publicly traded preferred securities between November 18, 1996 and October 18, 1998, inclusive.

2. The Preferred Purchaser Plaintiffs incorporate herein by reference, *in toto*, the Consolidated Complaint for Violation of the Securities Laws, dated April 8, 2002.

3. To the extent that this Supplement on behalf of the Preferred Purchaser Plaintiffs and the Consolidated Complaint are in conflict, the Consolidated Complaint is deemed conformed so as not to conflict with this Supplement.

ADDITIONAL PARTIES NOT NAMED IN THE CONSOLIDATED COMPLAINT

Additional Plaintiffs Not Named in the Consolidated Complaint

4. Plaintiff Henry H. Steiner purchased 585 shares of Enron Capital Trust II (preferred R stock) at $25.50 per share on July 8, 1997.

5. Henry H. Steiner, Trustee u/w/o Jakob Hirschberger purchased 1,000 shares of Enron Capital Trust II preferred stock at $25.25 per share on February 26, 1997.

Exhibit 3

6. Etta K. Steiner purchased 185 shares of Enron Capital Trust II at $25.50 per share on July 8, 1997.

7. The Eshe Fund (a New York not-for-profit corporation) purchased 1,000 shares of Enron Capital Trust II at $25.25 per share on February 26, 1997.

8. Plaintiff Dr. Thomas Barnett purchased 1,000 shares of Enron Capital Trust II at $25.39012 per share on May 16, 1997.

9. Plaintiff Esther Phillips Jackson (formerly known as Esther Phillips) purchased 1,200 shares of Enron Capital Trust II at $25.00 per share on January 14, 1997. Ms. Phillips Jackson is a resident of Texas.

10. Plaintiff Michael G. Palmiero purchased 200 shares of Enron Capital Trust I at $25.00 per share on November 18, 1996.

11. Plaintiff James A. Van Burgh purchased 500 shares of Enron Capital Trust I at $25.00 on or about November 18, 1996.

Additional Defendants Not Named in the Consolidated Complaint

Investment Banks

12. Dean Witter Reynolds Inc., A.G. Edwards & Sons, Inc., PaineWebber Incorporated, Rauscher Pierce Refsnes, Inc., Smith Barney Inc., Bear, Stearns & Co. Inc., and Prudential Securities Incorporated.

PLAINTIFFS' ADDITIONAL CLASS ACTION ALLEGATIONS

13. The Preferred Purchaser Plaintiffs bring the following claims: (1) for rescission only (and not damages) on behalf of all purchasers of Enron Capital Trust I preferred stock who, pursuant to the Registration Statement and prospectus issued in connection with the public offering, purchased their shares from the date of the public offering on November 18,

1996 through March 30, 1998, and (2) for rescission only (and not damages) on behalf of all purchasers of Enron Capital Trust II preferred stock who, pursuant to the Registration Statement and prospectus issued in connection with the public offering, purchased their shares from the date of the public offering on January 13, 1997 through October 18, 1998.

14. Enron's preferred stock includes, among others, the following different securities: (a) Enron Capital Trust I, 8.3% Series, 8 million shares outstanding, traded on the New York Stock Exchange, and (b) Enron Capital Trust II, 8.1250% series, 6 million shares outstanding, traded on the New York Stock Exchange.

DEFENDANTS' UNLAWFUL CONDUCT PRIOR TO THE FEDERAL CLASS PERIOD AND ADDITIONAL SCIENTER ALLEGATIONS

15. Defendant Andrew S. Fastow joined Enron in 1990.

16. The defendants' unlawful course of conduct began no later than in 1992 and became material no later than January 1, 1996.

17. Beginning at least as early as 1992, Enron manipulated various business and financial, reporting and accounting requirements in order (among other things) to artificially inflate earnings and decrease debt.

18. Beginning in 1992, according to records maintained by Andersen, Enron took advantage of accounting rules to count large loans from Wall Street firms as financial hedges instead of as debt on its balance sheet. The effect was to mask the actual state of Enron's financial condition. New York Times, 2/17/02.

19. Records held by Andersen show that Enron received $3.9 billion worth of such loans from 1992 through 2001. Of this amount, Enron received approximately $1.4 billion in misrepresented loans between 1992 through 1998, inclusive. New York Times, 2/17/02.

20. If Enron had in fact disclosed this money as debt, then credit rating agencies, industry analysts and investors would have known earlier that Enron was materially riskier than it appeared.

21. Also beginning in the early 1990s, Enron began using mark-to-market accounting more aggressively, when Skilling wanted to book profits faster. (CC ¶939).

22. Mark-to-market accounting was appropriate only where Enron had a long-term track record which gave it the ability to accurately estimate and forecast future values. (CC ¶36).

23. Enron misused and abused mark-to-market accounting throughout its entire business to grossly inflate its reported revenues and income.

24. Enron's use of mark-to-market accounting was even more severely reckless because Enron began using it more aggressively in the early 1990s when Enron had even less of a track record in these convoluted transactions upon which to base its estimates of revenue and value.

25. By falsifying revenues through the use of mark-to-market accounting, Enron managers were able to obtain larger bonuses based upon the inflated values. (CC ¶36).

26. One deal which used mark-to-market accounting was a deal involving a British power facility that earned Enron senior officials big bonuses. (CC ¶36).

27. Similarly, with respect to Enron's accounting for the value of long-term assets and investments, Enron became involved in building the India-Dabhol power plant project. It was to begin commercial operation in early 1997.

28. In 1995, after $300 million in work was completed, the project was halted due to political changes in India, and it would have been impossible to begin operation by early

1997. Even by 2002, the project was not yet finished. (CC ¶¶598, 614). Nevertheless, as late as 1998, no write-down or impairment charge had been taken against the value of this investment.

29. Similarly, Enron, with Mr. Fastow in a major role, began establishing certain partnerships and special purpose entities, including but not limited to JEDI, Obi 1, Chewco and Raptor (when collectively applicable, as to all special purpose entities whether named or not, "SPEs") no later than in 1991 and 1992 (and possibly as early as 1990).

30. As alleged in the Consolidated Complaint, the defendants created, structured, financed and used the partnerships and SPEs to enter into transactions with Enron for the specific purpose of inflating its profits and hiding its debt and losses, and thus to violate Generally Accepted Accounting Principles ("GAAP") and the principles of "fair presentation" of financial results.

31. Mr. Fastow was charged with implementing Mr. Skilling's "innovative plan" to create a "gas bank that would help struggling energy companies by providing them with loans in exchange for their oil and gas reserves, which Enron could hedge and trade against in its growing derivatives unit."

32. Thereafter, Enron began supporting energy producers by creating partnerships that allowed Enron to keep the debt off its balance sheet. The first of those partnerships was named Cactus.

33. By 1993, the partnerships Mr. Fastow had helped establish had become so pervasive and were so successful that the California Public Employees' Retirement System ("CALPERS") approached Enron about a joint venture.

34. In 1993, Enron established with CALPERS a partnership named Joint Energy Development Investments, known as JEDI.

35. JEDI was a Fastow controlled partnership (CC ¶813).

36. As early as in 1993, handwritten notes in CALPERS' files show that someone at CALPERS was concerned about whether the JEDI partnership was in conflict with the interests of Enron shareholders: the issue seemed to be whether the partnership's deals could benefit both the limited partners and Enron's shareholders. New York Times, 2/5/02.

37. Andersen provided audit and consulting services and was involved in the accounting for JEDI. (CC ¶945).

38. Later there were hundreds of other partnerships, with names like Obi 1, Chewco and Raptor.

39. Ties between Enron and Andersen stretch back to the late 1980s but became especially close in 1993 when Enron hired Andersen to conduct Enron's internal audit functions. Wall Street Journal, 1/21/02.

40. Andersen became Enron's certified public accountant no later than in 1989.

41. In 1993, when Andersen took over Enron's internal audit operation, 40 people moved from Enron's payroll to Andersen. Also in the early 1990s, Enron's Thomas Chambers, the energy trader's vice president of internal audit, left Enron to run the Andersen group assigned to Enron's internal audit. Wall Street Journal, 1/21/02.

42. As a result of taking over Enron's internal audit function, Andersen was in effect auditing its own work.

43. While the hiring of Andersen to take over Enron's internal audit operation made some Enron employees uneasy, they became even more troubled by the hiring of Andersen employees, among them Richard Causey, Enron's chief accounting officer (who joined

Enron in 1991), and Jeffrey McMahon, the company's chief financial officer. "It was like Arthur Andersen had people on the inside," said Judy Knepshield, formerly director of accounts payable at Enron. "The lines became very fuzzy." Wall Street Journal, 1/21/02.

44. Andersen helped Enron structure hundreds of highly complex partnerships, many of which had no apparent business purpose other than to conceal debt and losses. Andersen knew that many of the Fastow controlled partnerships were formed in offshore tax havens to hide their existence and operations from the IRS, Enron shareholders and the investment community. (CC ¶922).

45. James A. Hecker, a partner in Andersen's Houston office who specialized in energy issues, testified that he was skeptical since as least as early as 1995 about the growing focus on Enron in Andersen's Houston office. In 1997, he complained to D. Stephen Goddard, who oversaw Andersen's Houston office, about all the Andersen people invited by Enron to attend the Masters Golf Tournament in Augusta, Georgia. "It was a tough ticket to get," he said. Mr. Hecker said that he told Mr. Goddard that he believed Andersen's acceptance of so many tickets from Enron was "out of the realm of the normal relationship" between a client and auditor. Wall Street Journal, 5/9/02.

46. Beginning no later than 1993 and continuing through approximately 1997 (as detailed in the Consolidated Complaint ¶¶121(f), 214(o), 581, 614), Enron (particularly its international operations) improperly and repeatedly deferred start-up and proposal costs. These deferrals included development, financing and promotional fees and expenses that were incurred on failed project proposals. Enron took the escalating costs of bidding on large projects which it had lost and, instead of expensing those costs in the current period as required, rolled those costs over into some other unrelated international project that Enron was bidding on or actually

performing – in either event, avoiding recognizing those costs in the current period. These deferred expenses were accumulated for more than five years (between 1993 and 1997), a practice known inside Enron as "snowballing." By 1997, Enron had deferred a $100 million snowball on some 75 projects, which previously should have been written off.

47. Beginning in 1993, Enron began using a type of preferred stock which had been invented that year and Adesigned in such a way that it could be called either equity or debt, as needed. For the tax man, it resembled a loan, so that interest payments could be deducted from taxable income. For shareholders and rating agencies, who look askance at overleveraged companies, it resembled equity." The first preferred issue was Enron Capital LLC. Wall Street Journal, 2/4/02.

48. Unlike Enron common shares, which were geared towards and purchased by large institutional investors (such as state pension funds), the Enron preferred shares were primarily marketed to retail investors. For example, Merrill Lynch retail marketed Enron Capital Trust I. Wall Street Journal, 2/4/02.

49. The interests of individuals who purchased AMIPS@ and ATOPS@ (acronyms for two of Enron's preferred issues) and the other Enron preferred securities largely because of the regular coupon or dividend payments were markedly different from the interests of large institutional purchasers who purchased Enron common stock. Wall Street Journal, 2/4/02.

50. Although the Enron preferred securities were purchased largely because of the regular coupon or dividend payment, most of the preferred issues have no recourse to Enron's assets, thus starkly distinguishing them from bonds.

51. As alleged in the Consolidated Complaint, even early on, Lay, Skilling and Fastow began to inflate Enron's results by doing transactions with entities it controlled. In 1995, one James Alexander warned Lay that Enron was on a perilous path in this regard. He told Lay he perceived conflicts of interest between Enron and a company Alexander worked for, Enron Global Power and Pipelines, which had been formed by Enron to keep high-debt assets like power plants off Enron's balance sheet. Alexander told Lay that assertions of accounting irregularity were swirling within Enron and that there were stories of deal-makers enriching themselves to the Company's detriment. When confronted, Lay simply said he would have Enron's president look into the matter, ended the discussion and did nothing. Other former Global Power executives agreed that this was an early example of Enron's aggressive financial techniques and deal-making with controlled entities that lead to Enron's collapse: "We were the dead canary in the coal mine," Mr. Alexander said.

> Accounting principles generally prohibit a company from basing its profits on sales to a subsidiary. But Mr. Alexander's team worked closely with Enron's accounting firm, Arthur Andersen, and its main law firm, Vinson & Elkins, to create a corporate structure that allowed Enron to own 52 percent of the stock of Enron Global Power and Pipelines while maintaining that the unit was independent enough to characterize the sales as profit-making transactions. Mr. Alexander said, "How do you have a major interest without having control?" New York Times, 2/20/02.

52. The Report of Investigation by the Special Investigative Committee of the Board of Directors of Enron Corp. stated that "[t]hese partnerships were used by Enron management to enter into transactions that it could not, or would not, do with unrelated commercial entities. Many of the most significant transactions apparently were designed to accomplish favorable financial statement results, not to achieve bona fide economic objectives or to transfer risk. Some transactions were designed so that, had they followed applicable accounting rules, Enron could have kept assets and liabilities (especially debt) off of its balance

sheet; but the transactions did not follow those rules." Special Report at 4. Some of the transactions were done for the personal enrichment of Enron employees; some were implemented, improperly, to offset losses. Some of the major transactions were "clearly wrong" from the outset. Id. at 4-5.

53. According to a New York Times article of October 28, 2001, defendant Lay said he did not know some of the details about the deals involving Mr. Fastow. In response to one question about them, he said, "You're getting way over my head." This concession shows severe recklessness by defendant Lay because Mr. Fastow as a senior officer of the Company, the CFO, reported to Mr. Lay, the CEO; and, since Mr. Fastow was personally involved in the material transactions, it required that defendant Lay, a more senior officer above Mr. Fastow, have detailed knowledge of the transactions in order to give corporate approval. Accordingly, it was severely reckless for defendant Lay not to have detailed knowledge of these transactions where approval by an officer more senior to Mr. Fastow was required.

54. At a time before the end of 1996, Enron began planning to adopt a four-year program known as the Performance Unit Plan which would compensate Enron executives with cash bonuses if Enron's total shareholder return (a combination of dividends and the increase in the stock price) exceeded certain targets based upon a number of alternative investments.

55. Toward the end of 1996, Enron adopted the Performance Unit Plan.

56. When the four-year Plan terminated at approximately the end of calendar year 2000, one-time bonus payments totaling $320 million were paid to Enron executives the next month, in January 2001. New York Times, 3/1/02.

57. The Performance Unit Plan was planned, designed, and adopted for the purpose of personally enriching the Individual Defendants.

58. The existence of the Performance Unit Plan induced the Enron Defendants to unlawfully manipulate Enron's financial reporting and dissemination of information in order to artificially inflate Enron's stock price so that the Enron Defendants would receive huge bonuses.

59. Richard B. Buy joined Enron in 1994 as chief risk officer. He had primary responsibility for "quantifying and controlling risks in both Enron's trading activities and investment opportunities," according to his company biography. Wall Street Journal, 2/5/02.

60. Mr. Buy was a participant in the Performance Unit Plan. In early 2001, Mr. Buy received bonuses of $75,000, $900,000, and $695,000, for a total of $1,670,000.

61. It was severe recklessness for Mr. Buy to be permitted to participate in, and for him to participate in, the Performance Unit Plan. It was the equivalent of the fox guarding the hen house.

62. As alleged in the Consolidated Complaint (¶517), Enron has admitted that it refused to make proposed audit adjustments and reclassifications it was informed about by Andersen, for prior years including years prior to 1997, because it considered those adjustments "immaterial." For 1997, Enron admitted that the proposed adjustment was $51 million, which represented 48% of its net income and 10% of recurring net income for 1997.

63. Each time Enron notified Andersen of its refusal to make an adjustment (and given the general context of Enron's routine, overly aggressive tactics), such refusal constituted a red flag which should have put Andersen on notice.

64. On or about October 28, 1996, Enron filed a Registration Statement on Form S-3, later amended on November 13, 1996 and November 15, 1996, with respect to certain preferred securities (collectively, the "1996 Registration Statement"). The 1996 Registration Statement incorporated by reference Enron's 1995 Form 10-K, Enron's financial statements for 1995, which were audited by Andersen, and included Enron's results for the 1stQ, 2dQ and 3dQ 1996 pursuant to its Form 10-Qs. The effective date of the Registration Statement was on or about November 15, 1996.

65. The 1996 Registration Statement was signed by Robert A. Belfer, Norman P. Blake, Jr., Robert H. Butts, Ronnie C. Chan, John H. Duncan, Joe H. Foy, William D. Gathmann, Wendy L. Gramm, Robert L. Jaedicke, Richard D. Kinder, Kenneth L. Lay, Charles A. LeMaistre, John A. Urquhart, John Wakeham, Charls E. Walker, and Herbert S. Winokur, Jr.

66. Although he did not sign the 1996 Registration Statement for the Enron Capital Trust I offering, "the validity of the securities offered [by the offering was] passed upon for the Trust, the Partnership and Enron by" James V. Derrick, Jr., Esq., Senior Vice President and General Counsel of Enron.

67. The Prospectus to sell 8 million Enron Capital Trust I preferred shares at $25 per share was dated November 18, 1996.

68. The financial information contained in the prospectus was obtained from both the audited and unaudited consolidated financial statements of Enron, for the time period January 1, 1991 through September 30, 1996.

69. Specifically, the prospectus incorporated by reference Enron's 10-K for the year ended December 31, 1995; current report Form 8-K dated March 8, 1996; and the 10-Qs for the quarters ending March 31, 1996, June 30, 1996, and September 30, 1996, respectively.

70. The 1996 Registration Statement was materially false and misleading because, among other things, the financial results for at least 1995 and 1996 contained therein overstated Enron's earnings by material amounts and understated Enron debt by material amounts and it did not disclose that these financial results were calculated in violation of GAAP.

71. The 1995 10-K also was materially false and misleading when it stated:

> Domestic Gas and Power Services
> The domestic gas and power activities are conducted primarily by Enron Capital & Trade Resources (ECT) and include the marketing, purchasing and financing of natural gas, natural gas liquids, crude oil, power and other energy commodities and the management of the portfolio of commitments arising from these activities. The domestic gas processing operations are also included in this segment.
>
> ECT's stated objective is to provide solutions to energy problems worldwide. To meet this objective, ECT serves a diverse customer group that includes independent power producers, gas and electric utilities, industrials, oil and gas producers, financial institutions and other energy marketers. This broad customer mix generates a need for a variety of financial structures, products and terms. This diversity requires ECT to manage, on a portfolio basis, the resulting market risks inherent in these transactions. To provide a framework to manage such risks, ECT has defined a set of fundamental portfolio management principles, including formal definition of portfolio management responsibilities; continual evaluation of ECT's market risk, communicated and managed through risk limits and controls approved by Enron's Board of Directors; measurement of risk in accordance with value-at-risk methodologies and evaluation of business performance, including risk/return relationships. ECT has established portfolio management functions for both market and credit risk. Operating separately from the units that create or actively manage these risk exposures, ECT's Risk Control Group reports to an ECT Managing Director who reports extensively to the Audit Committee of the Enron Board of Directors. This group is responsible for the establishment of policies, measurement of the risks within ECT's portfolio and the communication of these risks to senior management and the Enron Board of Directors. This group is committed to the continuous review of the portfolio, policies and procedures to ensure that ECT's portfolio remains aligned with ECT's policies. . . .
>
> G. Accounting for Price Risk Management
> Enron engages in price risk management activities for both trading and non-trading purposes. Activities for trading purposes, generally consisting

of services provided to the energy sector through Enron Capital & Trade Resources (ECT), are accounted for using the mark-to-market method. Under such method, changes in the market value of outstanding financial instruments are recognized as gain or loss in the period of change. The market prices used to value these transactions reflect management's best estimate considering various factors including closing exchange and over-the-counter quotations, time value and volatility factors underlying the commitments. The values are adjusted to reflect the potential impact of liquidating Enron's position in an orderly manner over a reasonable period of time under present market conditions. . . .

Market Risk. To provide solutions to energy problems worldwide, ECT serves a diverse customer group that includes independent power producers, industrials, gas and electric utilities, oil and gas producers, financial institutions and other energy marketers. This broad customer mix generates a need for a variety of financial structures, products and terms. This diversity requires ECT to manage, on a portfolio basis, the resulting market risks inherent in these transactions subject to parameters established by Enron's Board of Directors. Market risks are monitored by a risk control group operating separately from the units that create or actively manage these risk exposures to ensure compliance with Enron's stated risk management policies at both the corporate and subsidiary levels. Risk measurement is also supplemented with stress testing and scenario analysis. ECT's fixed price contract portfolio is typically balanced to within approximately 1% of the gross position at the end of each day.

ECT measures the risk in its portfolio on a daily basis in accordance with value-at-risk methodologies, which simulate forward price curves in the energy markets to estimate the size and probability of future potential losses. The quantification of market risk using value-at-risk provides a consistent measure of risk across diverse energy markets and products. The use of this methodology requires a number of key assumptions including the selection of a confidence level for losses, the holding period chosen for the value-at-risk calculation and the treatment of risks outside the value-at-risk methodologies, including liquidity risk and event risk.

ECT expresses value-at-risk as a percentage of Enron's earnings based on a 95% confidence level using one day holding periods. On a one day basis as of December 31, 1995, ECT's value-at-risk for its price risk management activities was less than 2% (unaudited) of Enron's total income before interest, minority interest and income taxes. Since this is not an absolute measure of risk under all conditions for all products, ECT performs alternative scenario analyses to estimate the economic impact of a sudden market movement on the value of the trading portfolio (stress testing). The results of the stress testing, along with the professional judgments of experienced business and risk managers, are used to supplement the value-at-risk methodology and capture additional market-related risks, including liquidity, event, concentration and correlation reliance risk.

Based upon the ongoing policies and controls discussed above, Enron does not anticipate a materially adverse effect on financial position or results of operations as a result of market fluctuations.

Credit Risk. Credit risk relates to the risk of loss that Enron would incur as a result of nonperformance by counterparties pursuant to the terms of their contractual obligations. . . . ECT maintains credit policies with regard to its counterparties that management believes significantly minimize overall credit risk. These policies include an evaluation of potential counterparties' financial condition (including credit rating), collateral requirements under certain circumstances and the use of standardized agreements which allow for the netting of positive and negative exposures associated with a single counterparty. . . . Enron does not anticipate a materially adverse effect on financial position or results of operations as a result of counterparty nonperformance.

Non-Trading Activities . . . .
Credit Risk. While notional amounts are used to express the volume of various derivative financial instruments, the amounts potentially subject to credit risk, in the event of nonperformance by the third parties, are substantially smaller. Counterparties to the forwards, futures and other contracts discussed above are investment grade financial institutions. Accordingly, Enron does not anticipate any material impact to its financial position or results of operations as a result of nonperformance by the third parties on financial instruments related to non-trading activities.

72. The above statements in Enron's 10-K were materially false and misleading because (among other reasons, and in addition to the reasons set forth in the Consolidated Complaint): (1) the Risk Control Group's responsibilities and were reporting were a sham; (2) Enron did not use measurement of risk in accordance with value-at-risk methodologies and evaluation of business performance, including risk/return relationships; (3) the mark-to-market prices used did not reflect management's best estimate, but were determined for the purpose of falsely inflating the balance sheet; (4) the statement that Enron did not anticipate a materially adverse effect on financial position or results from market risk was both

materially false and contained material omissions; and (5) the statement that Enron does not anticipate any material impact to its financial position or results from the credit risk associated with non-trading activities was both materially false and contained material omissions.

73. The prospectus was materially false and misleading because, among other things: (1) the financial results for at least 1995 and 1996 contained therein overstated Enron's earnings by material amounts and understated Enron debt by material amounts; (2) it did not disclose that these financial results were calculated in violation of GAAP; (3) it did not disclose the extent to which Enron was creating and using SPEs; (4) it did not disclose the substance of the transactions with the SPEs including but not limited to that their purpose was to hide debt off balance sheet and falsely inflate revenues; (5) it did not disclose the extent to which Enron was entering into related-party transactions (6) it did not disclose the substance of the related-party transactions; (7) it did not disclose the material risk to Enron inherent in the SPE transactions, including from the increased leverage; and (8) it did not disclose that the manner in which Enron was now using SPEs constituted a material change in Enron's overall business and in its business and investment risk in its overall business.

74. On or about November 18, 1996, pursuant to the prospectus, Enron sold $200 million of preferred securities known as Enron Capital Trust I (8 million shares at $25.00 per share).

75. The co-lead underwriters for the offering were Merrill Lynch, Dean Witter Reynolds Inc., A.G. Edwards & Sons, Inc., PaineWebber Incorporated, Rauscher Pierce Refsnes, Inc. and Smith Barney Inc., and also as dealers CitiGroup and CS First Boston.

76. The underwriter defendants had a clear financial interest in consummating the Enron Capital Trust I offering, as they received a total of at least approximately $6.3 million

in underwriting fees from the offering and/or stood to benefit from the resulting ability of Enron to use the proceeds to repay short-term debt and for other general corporate purposes.

77. Enron used the proceeds of this securities issuance to pay down its short-term debt and for other general corporate purposes.

78. In January, 1997, Enron had another public offering of preferred securities, for Enron Capital Trust II.

79. On or about December 23, 1996, Enron filed a Registration Statement on Form S-3, later amended on January 9, 1997 and January 13, 1997, with respect to certain preferred securities (collectively, the "1997 Registration Statement). The 1997 Registration Statement incorporated by reference Enron's 1995 Form 10-K, Enron's financial statements for 1995, which were audited by Andersen, and included Enron's results for the 1stQ, 2dQ and 3dQ 1996 pursuant to its Form 10-Qs. The effective date of the Registration Statement was no earlier than January 13, 1997.

80. The 1997 Registration Statement was signed by Robert A. Belfer, Norman P. Blake, Jr., Robert H. Butts, Ronnie C. Chan, John H. Duncan, Joe H. Foy, William D. Gathmann, Wendy L. Gramm, Robert L. Jaedicke, Kenneth L. Lay, Charles A. LeMaistre, John A. Urquhart, John Wakeham, Charls E. Walker, and Herbert S. Winokur, Jr.

81. Although he did not sign the 1997 Registration Statement for the Enron Capital Trust II offering, "the validity of the securities offered [by the offering was] passed upon for the Trust, the Partnership and Enron by" James V. Derrick, Jr., Esq., Senior Vice President and General Counsel of Enron.

82. A Prospectus to sell 6 million Enron Capital Trust II preferred shares at $25 per share was dated January 13, 1997.

83. The financial information contained in the prospectus was obtained from both the audited and unaudited consolidated financial statements of Enron, for the time period January 1, 1991 through September 30, 1996.

84. Specifically, the prospectus incorporated by reference Enron's 10-K for the year ended December 31, 1995; current report Form 8-K dated March 8, 1996; and the 10-Qs for the quarters ending March 31, 1996, June 30, 1996, and September 30, 1996, respectively.

85. The 1997 Registration Statement was materially false and misleading because, among other things, the financial results for at least 1995 and 1996 contained therein overstated Enron's earnings by material amounts and understated Enron debt by material amounts and it did not disclose that these financial results were calculated in violation of GAAP.

86. The prospectus was materially false and misleading because, among other things: (1) the financial results for at least 1995 and 1996 contained therein overstated Enron's earnings by material amounts and understated Enron debt by material amounts; (2) it did not disclose that these financial results were calculated in violation of GAAP; (3) it did not disclose the extent to which Enron was creating and using SPEs; (4) it did not disclose the substance of the transactions with the SPEs including but not limited to that their purpose was to hide debt off balance sheet and falsely inflate revenues; (5) it did not disclose the extent to which Enron was entering into related-party transactions (6) it did not disclose the substance of the related-party transactions; (7) it did not disclose the material risk to Enron inherent in the SPE transactions, including from the increased leverage; and (8) it did not disclose that the manner in which Enron was now using SPEs constituted a material change in Enron's overall business and in its business and investment risk in its overall business.

87. On or about November 18, 1996, pursuant to the prospectus, Enron sold $200 million of preferred securities known as Enron Capital Trust I (8 million shares at $25.00 per share).

88. On or about January 13, 1997, with a settlement date of January 16, 1997, pursuant to the prospectus, Enron sold $150 million of preferred securities known as Enron Capital Trust II (6 million shares at $25.00 per share).

89. The co-lead underwriters for this offering were Merrill Lynch & Co., Bear, Stearns & Co. Inc., A.G. Edwards, Inc., PaineWebber Incorporated, Prudential Securities Incorporated and Smith Barney Inc., and also as dealers CitiGroup, CS First Boston, Deutche Bank and CIBC.

90. The terms of each offering contained the routine requirement that an Underwriting Agreement be entered into.

91. A routine term of such an agreement is cross-indemnification among the underwriters and dealers, with the requirement that if one underwriter learns of the existence of a claim against any of them, then that underwriter is obligated to notify the other underwriters and dealers of the existence of the claim.

92. Pursuant to an underwriting agreement, Merrill Lynch, as one of the lead underwriters, was under a duty to notify the other underwriters and dealers in each offering that claims were being asserted against them.

93. Because Merrill Lynch was named as a defendant in this action, Merrill Lynch, as a lead underwriter here, put the other underwriters and dealers in each offering on notice from the time of the original complaint that claims had been asserted against Merrill with respect to its underwritings for Enron.

94. Merrill Lynch, pursuant to standard industry practice, was under a duty to notify the other underwriters and dealers from each offering.

95. Enron used the proceeds of this securities issuance to pay down its short-term debt and for other general corporate purposes.

96. At the time of these two public offerings, Enron's common stock price was near its all time high, having reached 23 ¾ in late 1996. By the Fall of 1997, Enron's stock price had lost roughly one-third of its value. It did not exceed its all time high until no earlier than 1998.

97. Less than a week after the second public offering, on January 21, 1997, Enron issued a press release in which it reported a 12 percent increase in 1996 earnings per share. The press release also addressed the Enron then-named Capital and Trade Resources (ECT) earnings segment of its business, which concerned the marketing, purchasing and financing of energy products. ECT's activities, including its financing activities, are at issue herein. The press release quoted defendant Kenneth Lay as follows: "ECT's finance group enjoyed a solid year of earnings growth, completing five significant equity-based transactions with upstream companies in 1996. <u>All of ECT's core businesses</u> expanded their activities in 1996 and <u>are positioned for significant growth in 1997 and beyond</u>." (emphasis added). These statements concerning Enron's revenues, earnings and business prospects were materially false and omitted material facts.[1]

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[1] By 1997, Enron's off-balance sheet problems had further multiplied to the extent that Enron had difficulty finding an independent partner to buy out CALPERS' interest in JEDI. Because of CALPERS' involvement as the outside investor in JEDI, JEDI was deemed by defendants to have met the 3% outside equity and independent control conditions of federal law. Therefore, JEDI had been treated as independent of Enron and had not been consolidated into Enron's financial statements and results. Thus, Enron had been able to engage in transactions with JEDI (continued...)

98. Each 10Q, 10K, and press release with respect thereto, which Enron issued between the two public offerings and October 18, 1998 was materially false and misleading in that each overstated Enron's earnings, understated its debt, and omitted material facts as detailed herein with respect to the materially false and misleading nature of the Registration Statements and prospectuses.

FIFTH CLAIM FOR RELIEF
For Violation of TSA Art. 581-33A.2., for Liability of Sellers With Respect to an Untruth or Omission (Seeking Rescission Only); Concerning the Enron Capital Trust I and II Public Offerings, Including Aftermarket Trading Pursuant to the Prospectus

Enron Capital Trust I

99. Plaintiffs Michael G. Palmiero and James A. Van Burgh repeat and reallege the paragraphs set forth herein[2] (except for any which seek damages).

(...continued)
as an independent third party, recognize revenue and profits from those transactions and not carry JEDI's debt on Enron's books. However, the governing regulations stated that these standards did not apply to the SPEs Enron had created and that more than 3% might well be necessary depending on the circumstances.

In 1997, Enron could not find an outside party willing to purchase CALPERS' (its former partner's) 50% interest in JEDI, by year end. Mr. Fastow proposed listing his wife's family as outside investors, but his suggestion was apparently rebuffed. Enron, Vinson & Elkins and Kirkland & Ellis therefore quickly formed a new partnership called "Chewco" -- managed by Michael Kopper, a lower-level Enron employee -- to purchase CALPERS'- interest. Mr. Kopper worked under Mr. Fastow. As a lower level employee, Enron would not have to disclose his interest in SEC filings. Mr. Kopper would eventually make at least $10 million in profit from the venture. Because Enron was unable to locate an independent outside investor to quickly buy the 50% interest in JEDI, Barclays financed Chewco's purchase of CALPERS' JEDI interest with debt, not equity. Thus, from the outset, Chewco/JEDI was not a valid SPE meeting the requirements for non-consolidation. Notwithstanding this, Enron did not consolidate Chewco/JEDI into Enron's financial statements until at the earliest in late 2001 and used Chewco/JEDI to generate false profits from 1997 through 2001.

[2] "Set forth herein" means as set forth in both this Supplement to the Consolidated Complaint and in the Consolidated Complaint.

100. This Claim is brought pursuant to Texas Securities Act, Tex. Rev. Civ. Stat., art. 581-33, on behalf of plaintiffs Michael G. Palmiero and James A. Van Burgh and all other persons similarly situated who, pursuant to the Registration Statement and Prospectus issued in connection with the public offering, purchased Enron Capital Trust I preferred stock from November 18, 1996 (the date of the public offering, with a first settlement date of November 21, 1996) through March 30, 1998 (which is the day before the filing of Enron's 10-K for 1997, which was Enron's first 10-K to cover a period of at least twelve months beginning after the effective date of the Registration Statement).

101. This claim is brought against the following defendants:

(a) certain signatories to the offering documents, who were Robert A. Belfer, Norman P. Blake, Jr., Ronnie C. Chan, John H. Duncan, Joe H. Foy, Wendy L. Gramm, Robert L. Jaedicke, Kenneth L. Lay, Charles A. LeMaistre, John A. Urquhart, John Wakeham, Charls E. Walker, and Herbert S. Winokur, Jr.;

(b) James V. Derrick, who, although he did not sign the Registration Statement, in a written opinion passed upon "the validity of the securities offered;"

(c) Causey, Fastow, Skilling, Derrick, and Buy, although they did not sign the Registration Statement, by virtue of their positions as senior officers of Enron (even, as in the case of Mr. Buy, without corporate title), as set forth herein, directly or indirectly controlled Enron. Defendant Lay also controlled Enron.

(d) the underwriters for the offering, which were Merrill Lynch, Dean Witter Reynolds Inc., A.G. Edwards & Sons, Inc., PaineWebber Incorporated, Rauscher Pierce Refsnes, Inc. and Smith Barney Inc., CitiGroup, and CS First Boston.

102. The Enron Capital Trust I preferred stock public offering sold 8 million preferred shares at $25.00 per share, for a total of $200 million.

Jurisdictional Facts

103. Much of defendants' wrongful conduct occurred in and/or emanated from Texas.

104. Enron is headquartered in Houston, Texas.

105. Enron committed primary violations of the Texas Securities Act as both issuer and seller.

106. Andersen has an office in Houston, Texas.

107. Andersen personnel were present at Enron's Houston, Texas headquarters on a year-round basis. (CC ¶897).

108. Much of the unlawful conduct occurred in and/or emanated from Enron and Enron employees who were stationed in Houston, Texas.

109. Much of the unlawful conduct occurred in and/or emanated from Andersen and its employees in Andersen's office in Houston, Texas.

110. Defendant law firm Vinson & Elkins is headquartered in Texas. Much of the work performed by Vinson & Elkins attorneys for Enron was done out of Vinson's offices in Texas, including Houston, Texas.

111. Vinson & Elkins prepared the transaction documents on at least 35 deals included JEDI itself (CC ¶802).

112. Bracewell and Patterson L.L.P. is a law firm headquartered in Texas. Much of the work performed by Bracewell & Patterson attorneys for Enron was done out of Bracewell's offices in Texas, including Houston, Texas.

113. The preparation of the selling documents which contained the material misstatements and omissions, the 1996 Registration Statement and Prospectus, took place in Texas.

114. Defendant James V. Derrick, Jr., Esq., Senior Vice President and General Counsel of Enron, worked out of Enron's Houston headquarters. Mr. Derrick, in a written opinion letter, passed upon (for Enron and other entities involved in the offering) the validity of the preferred securities offered by the offering.

115. Mr. Derrick's opinion letter stated that he was a member of the bar of the State of Texas and that "the opinions set forth above are limited in all respects to the laws of the State of Texas, the Delaware General Corporation Law, the Delaware Revised Uniform Limited Partnership Act, the Delaware Business Trust Act and federal laws."

116. The 1996 Registration Statement and Prospectus also contained materially inaccurate financial statements for 1995, which were audited by Andersen, and for the first three quarters of 1996. The 1995 financial statement was prepared and audited in Texas. The unaudited quarterly statements were prepared in Texas.

117. The Registration Statement was signed in Texas by Texas citizens and filed with the SEC by an issuer from its headquarters in Houston.

118. The 1996 Registration Statement and Prospectus instructed persons seeking copies of Enron's SEC filings incorporated therein to contact Enron's "principal executive offices" in Houston, Texas.

119. Each of the underwriter defendants is a national broker-dealer which does business in all 50 states.

120. Each of the underwriter defendants: is legally registered as a broker-dealer in Texas; has been legally registered as a broker-dealer in Texas since no later than January 1, 1996, and in most or all instances for decade(s) before 1996; and does business in Texas.

121. Most or all of the underwriter defendants had offices in Texas.

122. The Enron Capital Trust I public offering was sold throughout the United States including in Texas to residents of Texas.

Additional Facts Concerning the Material Misstatements and Omissions

123. Enron (although not a defendant) was an issuer and a seller because it was the ultimate owner and beneficiary and used the proceeds of this securities offering to pay down its short-term debt and for other general corporate purposes.

124. The signatories to the offering documents, who were Robert A. Belfer, Norman P. Blake, Jr., Ronnie C. Chan, John H. Duncan, Joe H. Foy, Wendy L. Gramm, Robert L. Jaedicke, Kenneth L. Lay, Charles A. LeMaistre, John A. Urquhart, John Wakeham, Charls E. Walker, and Herbert S. Winokur, Jr., and James V. Derrick, offered for sale and/or sold, directly or indirectly, the Enron Capital Trust I preferred securities by virtue of their signatures on the offering documents and/or their acting as agent for Enron, the issuer.

125. Defendants Causey, Fastow, Skilling, Buy, Lay and Derrick offered for sale and/or sold, directly or indirectly, the Capital Trust I preferred securities by virtue of their positions as senior officers of Enron who directly or indirectly controlled Enron; and defendants Causey, Fastow, Skilling, Lay and Derrick offered for sale and/or sold, directly or indirectly, the Capital Trust I preferred securities by virtue of their positions as senior officer of Enron who were acting as agent for Enron, the issuer.

126. The underwriters for the Enron Capital Trust I offering offered for sale and/or sold, directly or indirectly, the Capital Trust I preferred securities to Messrs. Palmiero and Van Burgh and similarly situated members of the Subclass.

127. The defendants did the following acts in furtherance of the sale of the preferred securities:

a. They actively and jointly drafted, revised, approved and/or signed the Registration Statement and Prospectus by which the sale of the Enron Capital Trust I preferred securities was made to the investing public. The Registration Statement and Prospectus were "selling documents," calculated by these defendants to create interest the Capital Trust I preferred securities, were filed with the SEC and were widely distributed by defendants for that purpose.

b. The defendants finalized the Registration Statement and Prospectus, caused them to become effective and caused them to be provided to Messrs. Palmiero and Van Burgh and the similarly situated Subclass members. But for the defendants having drafted, filed, and/or signed the Registration Statement and Prospectus, the offering of the Capital Trust I preferred securities could not have been made.

128. Defendants offered for sale and/or sold, directly or indirectly, the Capital Trust I preferred securities to Messrs. Palmiero and Van Burgh and other members of the Subclass similarly situated by means of a Registration Statement and Prospectus and written and oral communications which were inaccurate and misleading as they contained untrue statements of material fact and/or omitted to state other facts necessary to make the statements made not materially misleading as described above. Messrs. Palmiero and Van Burgh and other members

of the Subclass similarly situated acquired the Enron Capital Trust I preferred securities from the defendants named herein.

129. The financial information contained in the prospectus was obtained from both the audited and unaudited consolidated financial statements of Enron, for the time period January 1, 1991 through September 30, 1996.

130. Specifically, the prospectus incorporated by reference Enron's 10-K for the year ended December 31, 1995; current report Form 8-K dated March 8, 1996; and the 10-Qs for the quarters ending March 31, 1996, June 30, 1996, and September 30, 1996, respectively.

131. According to GAAP, financial statements are complete only when they contain all material information necessary to represent validly the underlying events and conditions. Financial statements must disclose the financial effects of transactions and events that already have happened.

132. The 1996 Registration Statement was materially false and misleading because, among other things, the financial results for at least 1995 and 1996 contained therein overstated Enron's earnings by material amounts and understated Enron debt by material amounts and it did not disclose that these financial results were calculated in violation of GAAP.

133. Enron's 1995 10-K also was materially false and misleading because (among other reasons, and in addition to the reasons set forth in the Consolidated Complaint): (1) the Risk Control Group's responsibilities and were reporting were a sham; (2) the mark-to-market prices used did not reflect management's best estimate; (3) the statement that Enron did not anticipate a materially adverse effect on financial position or results from market risk was both materially false and contained material omissions; and (4) the statement that Enron does not

anticipate any material impact to its financial position or results from the credit risk associated with non-trading activities was both materially false and contained material omissions.

134. The prospectus was materially false and misleading because, among other things: (1) the financial results for at least 1995 and 1996 contained therein overstated Enron's earnings by material amounts and understated Enron debt by material amounts; (2) it did not disclose that these financial results were calculated in violation of GAAP; (3) it did not disclose the extent to which Enron was creating and using SPEs; (4) it did not disclose the substance of the transactions with the SPEs including but not limited to that their purpose was to hide debt off balance sheet and falsely inflate revenues; (5) it did not disclose the extent to which Enron was entering into related-party transactions (6) it did not disclose the substance of the related-party transactions; (7) it did not disclose the material risk to Enron inherent in the SPE transactions, including from the increased leverage; and (8) it did not disclose that the manner in which Enron was now using SPEs constituted a material change in Enron's overall business and in its business and investment risk in its overall business.

135. On or about November 18, 1996, pursuant to the prospectus, Enron sold $200 million of preferred securities known as Enron Capital Trust I (8 million shares at $25.00 per share).

136. Messrs. Palmiero and Van Burgh and the members of the Subclass similarly situated have been injured in that they paid artificially inflated prices for the Enron Capital Trust I preferred securities. Messrs. Palmiero and Van Burgh and the similarly situated Subclass members would not have purchased the Enron Capital Trust I preferred securities at the prices they paid, or at all, if they had been aware that the prices had been artificially inflated by defendants' misleading statements.

137. Messrs. Palmiero and Van Burgh and other members of the Subclass similarly situated purchased the Capital Trust I preferred securities from defendants pursuant to the false and misleading Registration Statement and Prospectus. Messrs. Palmiero and Van Burgh did not know, or in the exercise of reasonable diligence could not have known, of the untruths and omissions contained in the Registration Statement and Prospectus.

138. Each of the defendants issued, caused to be issued and/or participated in the issuance of materially false and misleading statements and/or misrepresented or failed to disclose, *inter alia*, the facts set forth above. As a direct and proximate result of defendants' acts and omissions in violation of the TSA, the price of the Enron Capital Trust I Preferred Securities was artificially inflated and Messrs. Palmiero and Van Burgh and the Subclass members suffered substantial injury in connection with their purchase of the Enron Capital Trust I preferred securities. By reason of the conduct herein alleged, each defendant violated the TSA.

139. On behalf of themselves and all members of the Preferred Purchaser Subclass (who, pursuant to the Registration Statement and prospectus, purchased their Enron Capital Trust I preferred shares from the date of the public offering on November 18, 1996 through March 30, 1998), Messrs. Palmiero and Van Burgh seek rescission (and not damages). Plaintiffs hereby tender to defendants Enron Capital Trust I preferred securities, on behalf of all members of the Preferred Purchaser Subclass who will tender the preferred securities, in return for the consideration paid for the preferred securities plus interest thereon at the legal rate from the date of payment by them, less the amount of any income they received on the security, pursuant to the Tex. Rev. Civ. Stat., art. 581-33.

140. At the times the Preferred Securities were purchased, Messrs. Palmiero and Van Burgh and the other members of the Subclass similarly situated were without

knowledge of the facts concerning the false or misleading statements or omissions alleged herein. Less than one year has elapsed from the time that Messrs. Palmiero and Van Burgh discovered or in the exercise of reasonable diligence could have discovered the facts upon which this Complaint is based to the time that he filed this Complaint. Less than five years elapsed from the time that the securities upon which this Claim is bought were *bona fide* offered to the public to the time that claims were first alleged herein.

141. From November 18, 1996 (the date of the public offering through March 30, 1998 (the date of the public offering, with a first settlement date of January 13, 1997), each of the underwriter defendants listed below participated in the following number of additional Enron securities underwritings, through which each underwriter knowingly engaged and participated in the ongoing scheme to defraud purchasers of Enron securities by reissuing through the prospectus for that subsequent public offering the same information about Enron which the underwriter knew to be both material and false: Merrill Lynch, 2 underwritings; and CitiGroup, 3 underwritings.

Enron Capital Trust II

142. Plaintiffs Henry H. Steiner; Henry H. Steiner, Trustee u/w/o Jakob Hirschberger; Etta K. Steiner; The Eshe Fund; Esther Phillips Jackson (formerly Esther Phillips), and Dr. Thomas Barnett repeat and reallege the paragraphs set forth herein (except for any which seek damages).

143. This Claim is brought pursuant to Texas Securities Act, Tex. Rev. Civ. Stat., art. 581-33, on behalf of plaintiffs Henry H. Steiner; Henry H. Steiner, Trustee u/w/o Jakob Hirschberger; Etta K. Steiner; The Eshe Fund; Esther Phillips Jackson (formerly Esther Phillips), Dr. Thomas Barnett and all other persons similarly situated who, pursuant to the Registration

Statement and Prospectus issued in connection with the public offering, purchased Enron Capital Trust II preferred stock from January 13, 1997 (the date of the public offering, with a first settlement date of January 16, 1997) through October 18, 1998. (Enron's first 10-K to cover a period of at least twelve months beginning after the effective date of the Registration Statement was filed on March 31, 1999; hence, this claim terminates with the beginning of the Federal Class Period.)

144. This claim is brought against the following defendants:

(a) certain signatories to the offering documents, who were Robert A. Belfer, Norman P. Blake, Jr., Ronnie C. Chan, John H. Duncan, Joe H. Foy, Wendy L. Gramm, Robert L. Jaedicke, Kenneth L. Lay, Charles A. LeMaistre, John A. Urquhart, John Wakeham, Charls E. Walker, and Herbert S. Winokur, Jr.;

(b) James V. Derrick, who, although he did not sign the Registration Statement, in a written opinion passed upon "the validity of the securities offered;"

(c) Causey, Fastow, Skilling, Derrick, and Buy, although they did not sign the Registration Statement, by virtue of their positions as senior officers of Enron, as set forth herein, directly or indirectly controlled Enron. Defendant Lay also controlled Enron.

(d) the underwriters for the offering, which were Merrill Lynch & Co., Bear, Stearns & Co. Inc., A.G. Edwards, Inc., PaineWebber Incorporated, Prudential Securities Incorporated and Smith Barney Inc., and also as dealers CitiGroup, CS First Boston, Deutche Bank and CIBC.

145. The Enron Capital Trust II preferred stock public offering sold 6 million preferred shares at $25.00 per share, for a total of $150 million.

Jurisdictional Facts

146. Much of defendants' wrongful conduct occurred in and/or emanated from Texas.

147. The preparation of the selling documents which contained the material misstatements and omissions, the 1997 Registration Statement and Prospectus, took place in Texas.

148. Mr. Derrick's opinion letter stated that he was a member of the bar of the State of Texas and that "the opinions set forth above are limited in all respects to the laws of the State of Texas, the Delaware General Corporation Law, the Delaware Revised Uniform Limited Partnership Act, the Delaware Business Trust Act and federal laws."

149. The 1997 Registration Statement and Prospectus also contained materially inaccurate financial statements for 1995, which were audited by Andersen, and for the first three quarters of 1996. The 1995 financial statement was prepared and audited in Texas. The unaudited quarterly statements were prepared in Texas.

150. The 1997 Registration Statement was signed in Texas by Texas citizens and filed with the SEC by an issuer from its headquarters in Houston.

151. The 1997 Registration Statement and Prospectus instructed persons seeking copies of Enron's SEC filings incorporated therein to contact Enron's "principal executive offices" in Houston, Texas.

152. Each of the underwriter defendants is a national broker-dealer which does business in all 50 states.

153. Each of the underwriter defendants: is legally registered as a broker-dealer in Texas; has been legally registered as a broker-dealer in Texas since no later than January 1, 1996, and in most or all instances for decade(s) before 1996; does business in Texas.

154. Most or all of the underwriter defendants had offices in Texas.

155. The Enron Capital Trust II public offering was sold throughout the United States including in Texas to residents of Texas.

Additional Facts Concerning the Material Misstatements and Omissions

156. Enron (although not a defendant) was an issuer and a seller because it was the ultimate owner and beneficiary and used the proceeds of this securities offering to pay down its short-term debt and for other general corporate purposes.

157. The signatories to the offering documents, who were Robert A. Belfer, Norman P. Blake, Jr., Ronnie C. Chan, John H. Duncan, Joe H. Foy, Wendy L. Gramm, Robert L. Jaedicke, Kenneth L. Lay, Charles A. LeMaistre, John A. Urquhart, John Wakeham, Charls E. Walker, and Herbert S. Winokur, Jr., and James V. Derrick, offered for sale and/or sold, directly or indirectly, the Enron Capital Trust I preferred securities by virtue of their signatures on the offering documents and/or their acting as agent for Enron, the issuer.

158. Defendants Causey, Fastow, Skilling, Buy, Lay and Derrick offered for sale and/or sold, directly or indirectly, the Capital Trust I preferred securities by virtue of their positions as senior officers of Enron who directly or indirectly controlled Enron; and defendants Causey, Fastow, Skilling, Lay and Derrick offered for sale and/or sold, directly or indirectly, the Capital Trust I preferred securities by virtue of their positions as senior officer of Enron who were acting as agent for Enron, the issuer.

159. The underwriters for the Enron Capital Trust II offering offered for sale and/or sold, directly or indirectly, the Capital Trust II preferred securities to plaintiffs and similarly situated members of the Subclass.

160. The defendants did the following acts in furtherance of the sale of the preferred securities:

a. They actively and jointly drafted, revised, approved and/or signed the Registration Statement and Prospectus by which the sale of the Enron Capital Trust II preferred securities was made to the investing public. The Registration Statement and Prospectus were "selling documents," calculated by these defendants to create interest the Capital Trust II preferred securities, were filed with the SEC and were widely distributed by defendants for that purpose.

b. The defendants finalized the Registration Statement and Prospectus, caused them to become effective and caused them to be provided to Mr. Palmiero and the similarly situated Subclass members. But for the defendants having drafted, filed, and/or signed the Registration Statement and Prospectus, the offering of the Capital Trust II preferred securities could not have been made.

161. Defendants offered for sale and/or sold, directly or indirectly, the Capital Trust II preferred securities to plaintiffs and other members of the Subclass similarly situated by means of a Registration Statement and Prospectus and written and oral communications which were inaccurate and misleading as they contained untrue statements of material fact and/or omitted to state other facts necessary to make the statements made not materially misleading as described above. Plaintiffs and other members of the Subclass similarly situated acquired the Enron Capital Trust II preferred securities from the defendants named herein.

162. The financial information contained in the prospectus was obtained from both the audited and unaudited consolidated financial statements of Enron, for the time period January 1, 1991 through September 30, 1996.

163. Specifically, the prospectus incorporated by reference Enron's 10-K for the year ended December 31, 1995; current report Form 8-K dated March 8, 1996; and the 10-Qs for the quarters ending March 31, 1996, June 30, 1996, and September 30, 1996, respectively.

164. According to GAAP, financial statements are complete only when they contain all material information necessary to represent validly the underlying events and conditions. Financial statements must disclose the financial effects of transactions and events that already have happened.

165. The 1997 Registration Statement was materially false and misleading because, among other things, the financial results for at least 1995 and 1996 contained therein overstated Enron's earnings by material amounts and understated Enron debt by material amounts and it did not disclose that these financial results were calculated in violation of GAAP.

166. Enron's 1995 10-K also was materially false and misleading because (among other reasons, and in addition to the reasons set forth in the Consolidated Complaint): (1) the Risk Control Group's responsibilities and were reporting were a sham; (2) the mark-to-market prices used did not reflect management's best estimate; (3) the statement that Enron did not anticipate a materially adverse effect on financial position or results from market risk was both materially false and contained material omissions; and (4) the statement that Enron does not anticipate any material impact to its financial position or results from the credit risk associated with non-trading activities was both materially false and contained material omissions.

167. The prospectus was materially false and misleading because, among other things: (1) the financial results for at least 1995 and 1996 contained therein overstated Enron's earnings by material amounts and understated Enron debt by material amounts; (2) it did not disclose that these financial results were calculated in violation of GAAP; (3) it did not disclose

the extent to which Enron was creating and using SPEs; (4) it did not disclose the substance of the transactions with the SPEs including but not limited to that their purpose was to hide debt off balance sheet and falsely inflate revenues; (5) it did not disclose the extent to which Enron was entering into related-party transactions (6) it did not disclose the substance of the related-party transactions; (7) it did not disclose the material risk to Enron inherent in the SPE transactions, including from the increased leverage; and (8) it did not disclose that the manner in which Enron was now using SPEs constituted a material change in Enron's overall business and in its business and investment risk in its overall business.

168. On or about January 13, 1997, pursuant to the prospectus, Enron sold $150 million of preferred securities known as Enron Capital Trust II (6 million shares at $25.00 per share).

169. The plaintiffs and members of the Subclass similarly situated have been injured in that they paid artificially inflated prices for the Enron Capital Trust II preferred securities. Plaintiffs and the similarly situated Subclass members would not have purchased the Enron Capital Trust II preferred securities at the prices they paid, or at all, if they had been aware that the prices had been artificially inflated by defendants' misleading statements.

170. Plaintiffs and other members of the Subclass similarly situated purchased the Capital Trust II preferred securities from defendants pursuant to the false and misleading Registration Statement and Prospectus. Plaintiffs did not know, or in the exercise of reasonable diligence could not have known, of the untruths and omissions contained in the Registration Statement and Prospectus.

171. Each of the defendants issued, caused to be issued and/or participated in the issuance of materially false and misleading statements and/or misrepresented or failed to

disclose, *inter alia*, the facts set forth above. As a direct and proximate result of defendants' acts and omissions in violation of the TSA, the price of the Enron Capital Trust II Preferred Securities was artificially inflated and plaintiffs and the Subclass members suffered substantial injury in connection with their purchase of the Enron Capital Trust II preferred securities. By reason of the conduct herein alleged, each defendant violated the TSA.

172. On behalf of themselves and all members of the Preferred Purchaser Subclass (who, pursuant to the Registration Statement and prospectus, purchased their Enron Capital Trust II shares from the date of the public offering on January 13, 1997 through October 18, 1998, plaintiffs seek rescission (and not damages). Plaintiffs hereby tender to defendants Enron Capital Trust II preferred securities, on behalf of all members of the Preferred Purchaser Subclass who will tender the preferred securities, in return for the consideration paid for the preferred securities plus interest thereon at the legal rate from the date of payment by them, less the amount of any income they received on the security, pursuant to the Tex. Rev. Civ. Stat., art. 581-33.

173. At the times the Preferred Securities were purchased, plaintiffs and the other members of the Subclass similarly situated were without knowledge of the facts concerning the false or misleading statements or omissions alleged herein. Less than one year has elapsed from the time that plaintiffs discovered or in the exercise of reasonable diligence could have discovered the facts upon which this Complaint is based to the time that he filed this Complaint. Less than five years elapsed from the time that the securities upon which this Claim is bought were *bona fide* offered to the public to the time that claims were first alleged herein.

174. From January 13, 1997 (the date of the public offering) through October 18, 1998 (Enron's first 10-K to cover a period of at least twelve months beginning after the

effective date of the Registration Statement was filed on March 31, 1999; hence, this claim terminates prior thereto with the beginning of the Federal Class Period), each of the underwriter defendants listed below participated in the following number of additional Enron securities underwritings, through which each underwriter knowingly engaged and participated in the ongoing scheme to defraud purchasers of Enron securities by reissuing through the prospectus for that subsequent public offering the same information about Enron which the underwriter knew to be both material and false: Merrill Lynch, 3 underwritings; CitiGroup, 3 underwritings; CS First Boston, 1 underwriting; and CIBC, 1 underwriting.

SIXTH CLAIM FOR RELIEF
For Violation of TSA Art. 581-33F.1., for Liability of Control Persons (Seeking Rescission Only); Concerning the Enron Capital Trust I and II Public Offerings, Including Aftermarket Trading Pursuant to the Prospectus

Enron Capital Trust I

175. Plaintiffs Michael G. Palmiero and James A. Van Burgh repeat and reallege the paragraphs set forth herein (except for any which seek damages).

176. This Claim is brought pursuant to Texas Securities Act, Tex. Rev. Civ. Stat., art. 581-33, on behalf of plaintiffs Michael G. Palmiero and James A. Van Burgh and all other persons similarly situated who, pursuant to the Registration Statement and Prospectus issued in connection with the public offering, purchased Enron Capital Trust I preferred stock from November 18, 1996 (the date of the public offering, with a first settlement date of November 21, 1996) through March 30, 1998 (which is the day before the filing of Enron's 10-K for 1997, which was Enron's first 10-K to cover a period of at least twelve months beginning after the effective date of the Registration Statement).

177. This claim is brought against the following defendants:

(a) the signatories to the offering documents, who were Robert A. Belfer, Norman P. Blake, Jr., Ronnie C. Chan, John H. Duncan, Joe H. Foy, Wendy L. Gramm, Robert L. Jaedicke, Kenneth L. Lay, Charles A. LeMaistre, John A. Urquhart, John Wakeham, Charls E. Walker, and Herbert S. Winokur, Jr., as set forth herein, directly or indirectly controlled Enron; and

(b) Causey, Fastow, Skilling, Lay, Derrick, and Richard B. Buy, who by virtue of their positions as senior officers of Enron, as set forth herein, directly or indirectly controlled Enron.

178. The Enron Capital Trust I preferred stock public offering sold 8 million preferred shares at $25.00 per share, for a total of $200 million.

179. The defendants prepared, reviewed, held a position of responsibility with respect to, and/or signed the Registration Statement and/or Prospectus, pursuant to which the defendants sold the Capital Trust I preferred securities to plaintiffs and the other members of the Subclass similarly situated.

180. Irrespective of the paragraph immediately above, and given their position as control persons, none of the defendants can sustain their burden of proof that (a) they did not know of the existence of the facts by reason of which the liability is alleged to exist and (b) in the exercise of reasonable care, they could not have known of the existence of the facts by reason of which the liability is alleged to exist.

181. As set forth herein, none of the individuals as defendants herein made a reasonable investigation or possessed reasonable grounds for the belief that the statements contained in the Registration Statement and Prospectus were true and did not omit any material fact and were not misleading. Additionally, defendants did not possess reasonable grounds for

the belief that the written and oral statements made by them were truthful and contained all facts necessary to make the statements made not misleading.

182. As set forth herein, Messrs. Lay, Skilling, Causey, Fastow, Derrick and Buy, each was in possession, directly or indirectly, of the power to direct or cause the direction of the management or policies of Enron, so that each of these defendants was in a position to prevent the violation of law and did not do so.

Enron Capital Trust II

183. Plaintiffs Henry H. Steiner; Henry H. Steiner, Trustee u/w/o Jakob Hirschberger; Etta K. Steiner; The Eshe Fund; Esther Phillips Jackson (formerly Esther Phillips), and Dr. Thomas Barnett repeat and reallege the paragraphs set forth herein (except for any which seek damages).

184. This Claim is brought pursuant to Texas Securities Act, Tex. Rev. Civ. Stat., art. 581-33, on behalf of plaintiffs Henry H. Steiner; Henry H. Steiner, Trustee u/w/o Jakob Hirschberger; Etta K. Steiner; The Eshe Fund; Esther Phillips Jackson (formerly Esther Phillips), Dr. Thomas Barnett and all other persons similarly situated who, pursuant to the Registration Statement and Prospectus issued in connection with the public offering, purchased Enron Capital Trust II preferred stock from January 13, 1997 (the date of the public offering, with a first settlement date of January 16, 1997) through October 18, 1998. (Enron's first 10-K to cover a period of at least twelve months beginning after the effective date of the Registration Statement was filed on March 31, 1999; hence, this claim terminates with the beginning of the Federal Class Period.)

185. This claim is brought against the following defendants:

(a) the signatories to the offering documents, who were Robert A. Belfer, Norman P. Blake, Jr., Ronnie C. Chan, John H. Duncan, Joe H. Foy, Wendy L. Gramm, Robert L. Jaedicke, Kenneth L. Lay, Charles A. LeMaistre, John A. Urquhart, John Wakeham, Charls E. Walker, and Herbert S. Winokur, Jr., as set forth herein, directly or indirectly controlled Enron; and

(b) Causey, Fastow, Skilling, Lay, Derrick, and Richard B. Buy, who by virtue of their positions as senior officers of Enron, as set forth herein, directly or indirectly controlled Enron.

186. The Enron Capital Trust II preferred stock public offering sold 6 million preferred shares at $25.00 per share, for a total of $150 million.

187. The defendants prepared, reviewed, held a position of responsibility with respect to, and/or signed the Registration Statement and/or Prospectus, pursuant to which the defendants sold the Capital Trust II preferred securities to plaintiffs and the other members of the Subclass similarly situated.

188. Irrespective of the paragraph immediately above, and given their position as control persons, none of the defendants can sustain their burden of proof that (a) they did not know of the existence of the facts by reason of which the liability is alleged to exist and (b) in the exercise of reasonable care, they could not have known of the existence of the facts by reason of which the liability is alleged to exist.

189. As set forth herein, none of the individuals as defendants herein made a reasonable investigation or possessed reasonable grounds for the belief that the statements contained in the Registration Statement and Prospectus were true and did not omit any material fact and were not misleading. Additionally, defendants did not possess reasonable grounds for

the belief that the written and oral statements made by them were truthful and contained all facts necessary to make the statements made not misleading.

190. As set forth herein, Messrs. Lay, Skilling, Causey, Fastow, Derrick and Buy, each was in possession, directly or indirectly, of the power to direct or cause the direction of the management or policies of Enron, so that each of these defendants was in a position to prevent the violation of law and did not do so.

SEVENTH CLAIM FOR RELIEF,
For Violation of TSA Art. 581-33F.2., for Liability of Aiders
With Respect to an Untruth or Omission (Seeking Rescission Only);
Concerning the Enron Capital Trust I and II Public Offerings,
Including Aftermarket Trading Pursuant to the Prospectus

Enron Capital Trust I

191. Plaintiffs Michael G. Palmiero and James A. Van Burgh repeat and reallege the paragraphs set forth herein (except for any which seek damages).

192. This Claim is brought pursuant to Texas Securities Act, Tex. Rev. Civ. Stat., art. 581-33, on behalf of plaintiffs Michael G. Palmiero and James A. Van Burgh and all other persons similarly situated who, pursuant to the Registration Statement and Prospectus issued in connection with the public offering, purchased Enron Capital Trust I preferred stock from November 18, 1996 (the date of the public offering, with a first settlement date of November 21, 1996) through March 30, 1998 (which is the day before the filing of Enron's 10-K for 1997, which was Enron's first 10-K to cover a period of at least twelve months beginning after the effective date of the Registration Statement).

193. This claim is brought against the following defendants:

(a) certain signatories to the offering documents, who were Robert A. Belfer, Norman P. Blake, Jr., Ronnie C. Chan, John H. Duncan, Joe H. Foy, Wendy L. Gramm, Robert

L. Jaedicke, Kenneth L. Lay, Charles A. LeMaistre, John A. Urquhart, John Wakeham, Charls E. Walker, and Herbert S. Winokur, Jr.;

(b) Causey, Fastow, Skilling, Derrick, Lay and Buy, by virtue of their positions as senior officers of Enron;

(c) the underwriters for the offering, which were Merrill Lynch, Dean Witter Reynolds Inc., A.G. Edwards & Sons, Inc., PaineWebber Incorporated, Rauscher Pierce Refsnes, Inc. and Smith Barney Inc., CitiGroup, and CS First Boston;

(d) Andersen; and

(e) Vinson & Elkins. Vinson & Elkins has been Enron's principal outside law firm for many years, since no later than approximately 1992. Vinson & Elkins participated in writing, reviewing and approving Enron's SEC filings, as well as shareholder reports and financial press releases. It also participated in setting up JEDI, Chewco and virtually all the related SPE transactions, knowing these were manipulative devices being used to falsify Enron's reported financial results and financial condition (CC ¶¶70(b), 98). It participated in drafting the offering documents for both Capital Trust I and Capital Trust II.

194. Enron has committed a primary violation of the Texas Securities Act.

195. At least one of the defendants identified in the allegations concerning the 581-33A.2. claim for seller liability also has committed a primary violation of the Texas Securities Act.

196. As set forth herein, each defendant had a general awareness of his role in at least one primary violation of the Act.

197. As set forth herein, each defendant, directly or indirectly, materially aided with substantial assistance a primary violation of the Act.

198. As set forth herein, each defendant either intended to deceive Mr. Palmiero and Mr. Van Burgh and other similarly situated members of the Subclass or each defendant acted with reckless disregard for the truth of the misrepresentations made by the primary violator.

Enron Capital Trust II

199. Plaintiffs Henry H. Steiner; Henry H. Steiner, Trustee u/w/o Jakob Hirschberger; Etta K. Steiner; The Eshe Fund; Esther Phillips Jackson (formerly Esther Phillips), and Dr. Thomas Barnett repeat and reallege the paragraphs set forth herein (except for any which seek damages).

200. This Claim is brought pursuant to Texas Securities Act, Tex. Rev. Civ. Stat., art. 581-33, on behalf of plaintiffs Henry H. Steiner; Henry H. Steiner, Trustee u/w/o Jakob Hirschberger; Etta K. Steiner; The Eshe Fund; Esther Phillips Jackson (formerly Esther Phillips), Dr. Thomas Barnett and all other persons similarly situated who, pursuant to the Registration Statement and Prospectus issued in connection with the public offering, purchased Enron Capital Trust II preferred stock from January 13, 1997 (the date of the public offering, with a first settlement date of January 16, 1997) through October 18, 1998. (Enron's first 10-K to cover a period of at least twelve months beginning after the effective date of the Registration Statement was filed on March 31, 1999; hence, this claim terminates with the beginning of the Federal Class Period.)

201. This claim is brought against the following defendants:

(a) certain signatories to the offering documents, who were Robert A. Belfer, Norman P. Blake, Jr., Ronnie C. Chan, John H. Duncan, Joe H. Foy, Wendy L. Gramm, Robert

L. Jaedicke, Kenneth L. Lay, Charles A. LeMaistre, John A. Urquhart, John Wakeham, Charls E. Walker, and Herbert S. Winokur, Jr.;

(b) Causey, Fastow, Skilling, Derrick, Lay and Buy, by virtue of their positions as senior officers of Enron;

(c) the underwriters for the offering, which were Merrill Lynch & Co., Bear, Stearns & Co. Inc., A.G. Edwards, Inc., PaineWebber Incorporated, Prudential Securities Incorporated and Smith Barney Inc., and also as dealers CitiGroup, CS First Boston, Deutche Bank and CIBC;

(d) Andersen; and

(e) Vinson & Elkins.

202. Enron has committed a primary violation of the Texas Securities Act.

203. At least one of the defendants identified in the allegations concerning the 581-33A.2. claim for seller liability also has committed a primary violation of the Texas Securities Act.

204. As set forth herein, each defendant had a general awareness of his role in at least one primary violation of the Act.

205. As set forth herein, each defendant, directly or indirectly, materially aided with substantial assistance a primary violation of the Act.

206. As set forth herein, each defendant either intended to deceive plaintiffs and other similarly situated members of the Subclass or each defendant acted with reckless disregard for the truth of the misrepresentations made by the primary violator.

PRAYER FOR RELIEF

WHEREFORE, the preferred purchaser plaintiffs pray for relief and judgment, including preliminary and permanent injunctive relief, as follows:

A. Determining that this action is a proper class action, and certifying the preferred purchaser plaintiffs as Subclass representatives under Rule 23 of the Federal Rules of Civil Procedure;

B. On the Fifth Claim, awarding rescission, with plaintiffs and the other Subclass members similarly situated tendering their Enron Capital Trust I and Enron Capital Trust II preferred securities, respectively, in return for the consideration paid for those preferred securities plus interest thereon at the legal rate from the date of payment by him, less the amount of any income received on the security, against all defendants, jointly and severally;

C. On the Sixth Claim, awarding rescission, with plaintiffs and the other Subclass members similarly situated tendering their Enron Capital Trust I and Enron Capital Trust II preferred securities, respectively, in return for the consideration paid for those preferred securities plus interest thereon at the legal rate from the date of payment by him, less the amount of any income received on the security, against all defendants, jointly and severally;

D. On the Seventh Claim, awarding rescission, with plaintiffs and the other Subclass members similarly situated tendering their Enron Capital Trust I and Enron Capital Trust II preferred securities, respectively, in return for the consideration paid for those preferred securities plus interest thereon at the legal rate from the date of payment by him, less the amount of any income received on the security, against all defendants, jointly and severally;

E. Awarding plaintiffs and the Class their reasonable costs and expenses incurred in this action, including counsel fees and expert fees; and

F. Such other and further relief as the Court may deem just and proper.

JURY DEMAND

The plaintiffs and the similarly situated Subclass members hereby demand a trial by jury on all issues which are triable to a jury.

Dated: July 9, 2002

WOLF HALDENSTEIN ADLER
FREEMAN & HERZ LLP

By: ______________________________
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Local Counsel for the Preferred Purchaser Plaintiffs

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Certificate of Service

I, D.W. Krasner hereby certify that I caused to be served the Preferred Purchaser Plaintiffs' Memorandum, with exhibits, and a proposed amended order, upon the law firms on the attached list. (Exhibit 3, the Supplement to the Consolidated Complaint, was served only upon Milberg Weiss and this Court.) I caused Milberg Weiss to be served by overnight delivery (for Monday delivery), with the remainder of the firms by U.S. Mail, postage-prepaid.

Daniel W. Krasner

Daniel W. Krasner BLC

The Service List

Attached

to this document

may be viewed at

the

Clerk's Office